



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

State Auditor's Office

*For the Two Fiscal Years Ended
June 30, 2012*

DECEMBER 2012

LEGISLATIVE AUDIT
DIVISION

12-20

**LEGISLATIVE AUDIT
COMMITTEE**

REPRESENTATIVES

RANDY BRODEHL
brodehl@centurytel.net

TOM BURNETT
Tburnetthd63@hotmail.com

VIRGINIA COURT
Vjchd52@yahoo.com

MARY McNALLY
mcnallyhd49@gmail.com

TRUDI SCHMIDT
trudischmidt@q.com

WAYNE STAHL, VICE CHAIR
westahl@nemontel.net

SENATORS

DEBBY BARRETT
grt3177@smtel.com

GARY BRANAE
garybranae@gmail.com

TAYLOR BROWN
taylor@northernbroadcasting.com

CLIFF LARSEN
cliff@larsenusa.com

FREDRICK (ERIC) MOORE
mail@SenatorEricMoore.com

MITCH TROPILA, CHAIR
tropila@mt.net

MEMBERS SERVE UNTIL A
MEMBER'S LEGISLATIVE TERM
OF OFFICE ENDS OR UNTIL A
SUCCESSOR IS APPOINTED,
WHICHEVER OCCURS FIRST.

§5-13-202(2), MCA

FRAUD HOTLINE
(STATEWIDE)
1-800-222-4446
(IN HELENA)
444-4446
ladhotline@mt.gov

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine whether an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2011, was issued March 29, 2012. The Single Audit Report for the two fiscal years ended June 30, 2013, will be issued by March 31, 2014. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
Room 277, State Capitol
P.O. Box 200802
Helena, MT 59620-0802

Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

AUDIT STAFF

JEANE CARSTENSEN-GARRETT
LAURA L.N. TOECKES

PAUL J. O'LOUGHLIN
ZAC YATES

Reports can be found in electronic format at:
<http://leg.mt.gov/audit>

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

December 2012

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the State Auditor's Office (office) for the two fiscal years ended June 30, 2012. Included in this report are recommendations concerning internal controls and compliance with state law and accounting policy over financial accounting. The office's written response to the audit recommendations is included in the audit report beginning on page B-1.

We thank the State Auditor and her staff for their assistance and cooperation during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

TABLE OF CONTENTS

Figures and Tables.....	ii
Elected, Appointed, and Administrative Officials.....	iii
Report Summary	S-1
CHAPTER I – INTRODUCTION	1
Introduction	1
Office Background and Organization.....	2
Prior Audit Recommendations.....	3
CHAPTER II – FINDINGS AND RECOMMENDATIONS.....	5
Departure from Established Segregation of Duties	5
Accounting Errors	6
Trust Fund Misstatements	6
Direct Entries to Fund Balance.....	7
INDEPENDENT AUDITOR’S REPORT AND OFFICE FINANCIAL SCHEDULES	
Independent Auditor’s Report	A-1
Schedule of Changes in Fund Balances & Property Held in Trust for the Fiscal Year Ended June 30, 2012.....	A-3
Schedule of Changes in Fund Balances & Property Held in Trust for the Fiscal Year Ended June 30, 2011	A-4
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2012.....	A-5
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2011	A-6
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2012.....	A-7
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2011	A-8
Notes to the Financial Schedules	A-9
OFFICE RESPONSE	
State Auditor’s Office	B-1

FIGURES AND TABLES

Tables

Table 1	Summary of Deficiencies in Internal Control	1
Table 2	Private-Purpose Trust Fund Misstatements.....	7

ELECTED, APPOINTED, AND ADMINISTRATIVE OFFICIALS

State Auditor's Office Monica Lindeen, State Auditor
 Adam Schafer, Deputy State Auditor
 Lynne Egan, Deputy Securities Commissioner
 Christine Kaufmann, Deputy Insurance Commissioner
 Christi Jacobsen, Central Services Administrator

			<u>Term Expires</u>
Insure Montana Board Members	Betty Beverly	Helena	January 2013
	Katherine Buckley-Patton	Helena/Dillon	January 2013
	Erin McGowan Fincham	Helena	June 2013
	Amanda Harrow	Helena	January 2014
	David Kendall	Missoula	June 2014
	John Thomas	Helena	January 2015
	Susan Witte	Helena	June 2015
	Jessica Rhoades*	Helena	
	Carol Roy*	Helena	

*These board members serve at the pleasure of the Governor and State Auditor as nonvoting staff appointments to the board.

For additional information concerning the State Auditor's Office, contact Monica Lindeen:

State Auditor's Office
 P. O. Box 4009
 Helena, MT 59604-4009
 (406) 444-2040
 e-mail: mlindeen@mt.gov



MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

State Auditor's Office

For the Two Fiscal Years Ended June 30, 2012

DECEMBER 2012

12-20

REPORT SUMMARY

The State Auditor's Office (office) collected over \$65 million in General Fund revenue in each of the fiscal years 2010-11 and 2011-12. While the office's operations provide significant revenue streams to the General Fund, it uses no General Fund money for its operations. The results of the audit indicate accounting errors related to the office's insurance policyholder trusts.

Context

The State Auditor's Office regulates the insurance and securities industries in Montana. Its duties include, but are not limited to, resolving consumer inquiries and complaints, licensing companies and individuals, conducting routine examinations, investigating code and rule violations, and prosecuting violators.

The office also acts as a revenue collection agency for the state's General Fund. In this capacity, the office collected over \$65 million in General Fund revenue in each of the fiscal years 2010-11 and 2011-12. The office distributed about \$25 million and \$26 million of insurance premium taxes collected to the Firefighters' Unified Retirement System, the Volunteer Firefighters pension trust fund, and local police and fire department pension trust funds as nonemployer contributions in fiscal years 2010-11 and 2011-12, respectively.

The office continued to administer the Insure Montana Program. The program expended approximately \$11.5 million and \$9 million in fiscal years 2010-11 and 2011-12, respectively, in health insurance premium assistance and tax credit benefits.

Results

This report contains the audited financial schedules for the two fiscal years ended June 30, 2012. Our audit identified accounting errors involving the office's private-purpose trust fund and direct entries to fund balances. As discussed in the report, the office used an incorrect fund classification in 2010-11 and did not report the private-purpose trust fund in its entirety in 2011-12. Additionally, the report describes a control deficiency over insurance premium tax collections where the office did not separate the custody of assets duties with record keeping duties.

Recommendation Concurrence	
Concur	3
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

For a complete copy of the report (12-20) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at <http://leg.mt.gov/audit>

Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE

Call toll-free 1-800-222-4446, or e-mail ladhotline@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the State Auditor's Office (office) for the two fiscal years ended June 30, 2012. The objectives of the audit were:

1. To obtain an understanding of the office's control structures to the extent necessary to support the audit of its financial schedules and, where necessary, make recommendations for improvement in the office's management and internal controls.
2. To determine the office's compliance with selected state laws and regulations during the two fiscal years ending June 30, 2012.
3. To determine the implementation status of prior audit recommendations.
4. To determine whether the office's financial schedules present fairly its financial position and results of operations as of, and for each of the fiscal years ended June 30, 2011, and June 30, 2012.

This report contains three recommendations to the office. In accordance with §5-13-307, MCA, we analyzed and disclosed, if significant, the costs of implementing the recommendations made in this report.

Auditing standards require us to communicate, in writing, deficiencies in internal control we identified as a result of audit objective #1 above and considered to be significant or material. A deficiency in internal control exists when the design or operation of a control does not allow management or employees to prevent or detect and correct misstatements on a timely basis. A material weakness is one or more deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented or detected and corrected on a timely basis. A significant deficiency is one or more deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Table 1 outlines the status of significant deficiencies and material weaknesses we identified during this audit.

Table 1
Summary of Deficiencies in Internal Control

Subject	Type of Deficiency	Page
Departure from Controls over Payments Received by Mail	Material Weakness	5
Accounting Errors Resulting in Material Misstatements	Material Weakness	6

Office Background and Organization

The State Auditor is the Commissioner of Insurance and the Commissioner of Securities. The State Auditor also serves as a member of the State Land Board and the Crop Hail Insurance Board. The office licenses and regulates insurance companies and agents within the state, and regulates and registers securities dealers.

The office is organized as follows:

Centralized Management (16.8 FTE) is responsible for the administrative, budgeting, personnel, and accounting functions of the office. The division also provides support for the State Auditor as she fulfills her duties on the State Land Board and the Crop Hail Insurance Board. The office is responsible for distributing a portion of insurance premium taxes to the Montana Public Employees' Retirement Administration for the Firefighters' Unified Retirement System and the Volunteer Firefighters pension trust fund and to fire and police departments in qualifying Montana cities and towns.

Insurance Division (58 FTE) regulates the insurance industry in Montana. Its duties include: resolving insurance consumer inquiries and complaints about agents, coverage, and companies; licensing and reviewing the rates and financial condition of insurance companies; collecting the insurance premium tax; approving forms used by insurance companies; licensing, testing, and administering a continuing education program for insurance agents; and investigating insurance code and rule violations.

The division administers the Insure Montana Program, a two-part program that is designed to assist small businesses with the cost of health insurance, whether they have previously provided health insurance or not. The program has a tax credit program and a premium assistance program. Eligible employers participating in the tax credit program claim a refundable credit on their annual state income tax return. Eligible employers participating in the premium assistance program may choose to provide their employees group health insurance through a Qualified Association Health Plan (QAP) or through Insure Montana's purchasing pool. Whichever plan the employer chooses, the employer will receive incentive payments and the employees will receive assistance payments monthly to assist with the cost of coverage.

Securities Division (12 FTE) is responsible for the administration and enforcement of the Securities Act of Montana. The division is responsible for the registration of securities issuers, salespeople, investment advisers, broker-dealers, and investment adviser representatives. It also investigates instances of unregistered or fraudulent securities transactions.

Prior Audit Recommendations

The prior financial-compliance audit of the office for the two fiscal years ended June 30, 2010, contained two recommendations. We determined the office implemented both of the recommendations.

Chapter II – Findings and Recommendations

Departure from Established Segregation of Duties

Due to high volume of payments received by mail, the State Auditor's Office (office) departed from established policy segregating the custody of payments from record keeping functions.

The office established an internal control policy for receiving payments by mail. The policy requires mailroom personnel process all incoming mail daily. A mailroom employee opens the mail, restrictively endorses the checks, and records checks on a daily receipt log. A second employee prepares the bank deposit. Program staff receive the mail without the checks and record the deposit within the accounting system.

One week each year, the office receives up to \$9 million of insurance premium tax revenues. Due to the high volume of receipts, the office departed from its established policy in both fiscal years 2011-12 and 2010-11. Program staff opened mail and restrictively endorsed checks, a responsibility assigned to the mailroom in the office's internal control policy. Program staff keep a record of all licensed insurers submitting proper payment and follow-up with further collection efforts when necessary. The program staff could mark the business as paid-in-full on their records without drawing further attention to the taxpayer's account. The departure from the policy places these program staff in a vulnerable position increasing the risk of misappropriation without timely detection.

When we identified the departure from the office's internal control policy, we immediately communicated the occurrence to office personnel in a position to change the practice. These personnel did not realize the practice was contrary to their policy, explaining the office has always allowed program staff to open mail during the busy period in order to have timely deposits. Once notified, office personnel decided to implement monitoring procedures to ensure all expected payments were received. Although the office implemented the monitoring procedures in fiscal year 2011-12, the control deficiency existed in fiscal years 2011-12 and 2010-11. The office's policy is not adequate for processing high volumes of receipts through its mail room. State accounting policy requires agencies develop appropriate internal control procedures based upon their business processes. In order to comply with state policy, the office should enhance its policy over collections by mail to allow for proper segregation of duties during high volume revenue collections.

RECOMMENDATION #1

We recommend the office enhance existing policies to incorporate segregation of duties during high revenue collection periods.

Accounting Errors

The office did not record financial activity of policyholder trusts and other current activity as required by state law and accounting policy.

Trust Fund Misstatements

State law requires agencies input all necessary transactions to the accounting system before the accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with Generally Accepted Accounting Principles. To protect insurance policyholders, insurers transfer securities to the commissioner to be held in trust as required by state law. A private-purpose trust fund is used to report a trust arrangement where the principal and income benefit individuals, private organizations, or other governments. An agency fund is used to account for activity when the state's role is purely custodial. The office routinely reviews policyholder trust balances for compliance with state law and authorizes contributions and distributions from the trusts. Given the office's role of authorizing contributions and distributions, it must record the activity in a private-purpose trust fund.

In fiscal year 2010-11, the office accounted for the activity in an agency fund rather than the private-purpose trust fund. The agency fund does not account for revenues and expense activities given its custodial nature. As a result, revenue and expense activity related to policyholder trusts were not recorded on the primary accounting records. We determined the potential trust contributions and distributions to be \$2,309,752 and \$155,226, respectively, in fiscal year 2010-11.

Office staff said they accounted for the deposits in the agency fund due to an audit recommendation dating back to 1998. However, in 2001, accounting principles became effective creating the private-purpose trust fund. Office staff were not aware of the difference between the agency fund and the private-purpose trust fund and continued their agency fund classification until fiscal year 2011-12.

The Department of Administration's Accounting Bureau prompted the office to reclassify the trust to the private-purpose trust fund in fiscal year 2011-12. Although the office reclassified the fund, it did not appropriately record revenues and expenses. Additionally, the office did not follow state accounting policy of establishing fund balance through a "direct entry to fund balance" for changes in fund classification. The following table presents errors existing in the fiscal year 2011-12 accounting records in the private-purpose trust fund.

Table 2
Private-Purpose Trust Fund Misstatements
Fiscal Year 2011-12

Account	Total Misstatements Over/(Under)
Fund Balance-Restricted, June 30, 2012	(\$13,524,617)
Accountability for Property Held in Trust (Liability), June 30, 2012	\$13,524,617
Contributions to Private-Purpose Trust (Revenue)	(\$775,541)
Benefits and Claims-From Other Sources (Expenses)	(\$90,951)

Source: Compiled by the Legislative Audit Division from State Auditor's Office records.

When the office considered how to account for the trust in fiscal year 2011-12, it relied on the Accounting Bureau's direction. Office staff indicated the Accounting Bureau directed the office to continue accounting for the trust as a custodian. The office recorded a liability for the total value of assets held in the trusts, as would be appropriate in the agency fund. However, the office's responsibilities for authorizing trust contributions and distributions do not support a custodial capacity, and the liability should not have been recorded.

RECOMMENDATION #2

We recommend the office account for its private-purpose trust fund activity in accordance with state law and accounting policy.

Direct Entries to Fund Balance

In fiscal year 2011-12, the office did not follow state accounting policy over the appropriate use of direct entries to fund balance. Direct entries to fund balance do not result in recognition of revenues and expenditures. State accounting policy provides

that direct entries to fund balance may be used to correct errors in the accounting records dating back two fiscal years.

- ♦ The office received a payment for insurance premium taxes dating back to 1985. The office recorded the collection as a direct entry to fund balance in the General Fund to correct prior years revenue. However, prior year revenue, for accounting purposes, was not in error. State accounting policy requires revenue should be recorded in the period it is realizable, measurable, earned, and available within 60 days of year-end, or shortly thereafter. The payment did not meet the terms in state accounting policy until fiscal year 2011-12; therefore, the use of direct entries to fund balance was not appropriate. As a result, General Fund revenues were understated by \$685,773. The error does not affect fund balance. Additionally, the office used direct entries to fund balance instead of transfers-out when it transferred \$352,282 to the Department of Labor and Industry for its share of the settlement, understating transfers-out of the Insurance Program. Again, the use of a direct entry to fund balance was not appropriate because the transfer represents current activity and not a correction of an error.
- ♦ The office started recording a correcting entry for Insure Montana activity (2006-07 through 2009-10) as a direct entry to fund balance. The adjustment affected both the office's records and the Department of Public Health and Human Service's (DPHHS) records. The accounting system required authorization by both agencies. DPHHS did not authorize the entry because of a disagreement over using a direct entry to fund balance. Office personnel explained they ran out of time at fiscal year-end to resolve the dispute. The office completed the transaction using reductions to transfers-in instead of reductions directly to fund balance. The error caused State Special Revenue Fund transfers-in to be understated by \$641,260. The office should pursue a resolution with the help of the Department of Administration.

In the first example, the office recorded direct entries to fund balance when it should have recorded revenue and transfers-out. In the second example, the office recorded reductions to transfers-in when it should have recorded a direct entry to fund balance.

RECOMMENDATION #3

We recommend the office follow state accounting policy when recording current activity versus corrections of errors through direct entries to fund balance.

Independent Auditor's Report and Office Financial Schedules

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Angus Maciver

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the State Auditor's Office (office) for each of the fiscal years ended June 30, 2012, and 2011. The information contained in these financial schedules is the responsibility of the office's management. Our responsibility is to express opinions on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in note 1, these financial schedules are prepared on the basis of Montana state accounting policy, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the office's assets and liabilities.

As discussed in note 4, the office reported policyholder trusts in the agency fund instead of the private-purpose trust fund in fiscal year 2010-11 on the Schedule of Changes to Fund Balances & Property Held in Trust. The results of the error are presented in the following table.

<u>Agency Fund</u>	<u>Amount Overstated</u>	<u>Private-Purpose Trust Fund not Reported</u>	<u>Amount</u>
Property Held in Trust: July 1, 2010	\$10,685,501	Fund Balance: July 1, 2010	\$10,685,501
Additions to Property Held in Trust	\$2,309,752	Nonbudgeted Revenues & Transfers-In	\$2,309,752
Reductions in Property Held in Trust	\$155,226	Nonbudgeted Expenditures & Transfers-Out	\$155,226
Property Held in Trust: June 30, 2011	\$12,840,027	Fund Balance: June 30, 2011	\$12,840,027

Due to an error in accounting, the office's Schedule of Changes in Fund Balances & Property Held in Trust for fiscal year 2011-12 does not report the private-purpose trust fund financial position and results of operations consisting of Direct Entries to Fund Balance of \$12,840,027, Nonbudgeted Revenues and Transfers-In of \$775,541, Nonbudgeted Expenditures and Transfers-Out of \$90,951, and the June 30, 2012, Ending Fund Balance of \$13,524,617.

In our opinion, except for the effect of the errors in the preceding paragraphs, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances/property held in trust of the State Auditor's Office for each of the fiscal years ended June 30, 2012, and 2011, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor

November 16, 2012

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Agency Fund
FUND BALANCE: July 1, 2011	\$ <u>(24,620,512)</u>	\$ <u>10,204,035</u>	\$ <u>0</u>	\$ <u>0</u>
PROPERTY HELD IN TRUST: July 1, 2011				\$ <u>12,840,027</u>
ADDITIONS				
Budgeted Revenues & Transfers-In	66,666,427	33,279,750	862,859	
Nonbudgeted Revenues & Transfers-In	5,015,544	156,528		
Prior Year Revenues & Transfers-In Adjustments	16,160	(144,998)		
Direct Entries to Fund Balance	<u>(46,300,255)</u>	<u>(10,076,371)</u>		
Total Additions	<u>25,397,876</u>	<u>23,214,909</u>	<u>862,859</u>	<u>0</u>
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	26,326,677	18,253,428	862,917	
Nonbudgeted Expenditures & Transfers-Out		5,160,589		
Prior Year Expenditures & Transfers-Out Adjustments	1,339	(170,625)		
Reductions in Property Held in Trust				<u>12,840,027</u>
Total Reductions	<u>26,328,016</u>	<u>23,243,392</u>	<u>862,917</u>	<u>12,840,027</u>
FUND BALANCE: June 30, 2012	\$ <u>(25,550,652)</u>	\$ <u>10,175,552</u>	\$ <u>(58)</u>	\$ <u>0</u>
PROPERTY HELD IN TRUST: June 30, 2012				\$ <u>0</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Agency Fund
FUND BALANCE: July 1, 2010	\$ <u>(25,018,242)</u>	\$ <u>9,729,117</u>	\$ <u>0</u>	\$ <u>0</u>
PROPERTY HELD IN TRUST: July 1, 2010				\$ <u>10,823,305</u>
ADDITIONS				
Budgeted Revenues & Transfers-In	65,286,506	34,303,928	805,967	
Nonbudgeted Revenues & Transfers-In	3,299,319	101,982		
Prior Year Revenues & Transfers-In Adjustments	(11,356)	(96,240)		
Direct Entries to Fund Balance	(43,157,446)	(10,794,525)		
Additions to Property Held in Trust				15,744,274
Total Additions	<u>25,417,023</u>	<u>23,515,145</u>	<u>805,967</u>	<u>15,744,274</u>
REDUCTIONS				
Budgeted Expenditures & Transfers-Out	25,119,952	19,786,409	805,967	
Nonbudgeted Expenditures & Transfers-Out		3,302,741		
Prior Year Expenditures & Transfers-Out Adjustments	(100,659)	(48,923)		
Reductions in Property Held in Trust				13,727,552
Total Reductions	<u>25,019,293</u>	<u>23,040,227</u>	<u>805,967</u>	<u>13,727,552</u>
FUND BALANCE: June 30, 2011	\$ <u>(24,620,512)</u>	\$ <u>10,204,035</u>	\$ <u>0</u>	\$ <u>0</u>
PROPERTY HELD IN TRUST: June 30, 2011				\$ <u>12,840,027</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Licenses and Permits	\$ 6,988,710	\$ 12,259,207		\$ 19,247,917
Taxes	58,931,809	10,551,668		69,483,477
Charges for Services		1,038,923		1,038,923
Fines and Forfeits	762,068			762,068
Grants, Contracts, and Donations		143,361		143,361
Transfers-in	5,015,544	9,222,439		14,237,983
Federal Indirect Cost Recoveries		38,282		38,282
Miscellaneous		37,400		37,400
Federal			\$ 862,859	862,859
Total Revenues & Transfers-In	71,698,131	33,291,280	862,859	105,852,270
Less: Nonbudgeted Revenues & Transfers-In	5,015,544	156,528		5,172,072
Prior Year Revenues & Transfers-In Adjustments	16,160	(144,998)		(128,838)
Actual Budgeted Revenues & Transfers-In	66,666,427	33,279,750	862,859	100,809,036
Estimated Revenues & Transfers-In	66,667,102	33,280,630	844,384	100,792,116
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (675)	\$ (880)	\$ 18,475	\$ 16,921
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Licenses and Permits	\$ (291)	\$ (141)		\$ (431)
Taxes	(65)	(133)		(198)
Charges for Services		(313)		(313)
Fines and Forfeits	(318)			(318)
Grants, Contracts, and Donations		(1)		(1)
Transfers-in		(65)		(65)
Federal Indirect Cost Recoveries		(69)		(69)
Miscellaneous	(1)	(159)		(160)
Federal			\$ 18,475	18,475
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (675)	\$ (880)	\$ 18,475	\$ 16,920

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

A-6

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS				
Licenses and Permits	\$ 6,943,033	\$ 10,974,335		\$ 17,917,368
Taxes	57,931,334	10,077,751		68,009,085
Charges for Services		350,639		350,639
Fines and Forfeits	400,783			400,783
Grants, Contracts, and Donations		100,000		100,000
Transfers-in	3,299,319	12,508,770		15,808,089
Capital Asset Sale Proceeds		1,116		1,116
Federal Indirect Cost Recoveries		58,827		58,827
Miscellaneous		238,232		238,232
Federal			\$ 805,967	805,967
Total Revenues & Transfers-In	68,574,469	34,309,670	805,967	103,690,106
Less: Nonbudgeted Revenues & Transfers-In	3,299,319	101,982		3,401,301
Prior Year Revenues & Transfers-In Adjustments	(11,356)	(96,240)		(107,596)
Actual Budgeted Revenues & Transfers-In	65,286,506	34,303,928	805,967	100,396,401
Estimated Revenues & Transfers-In	65,286,900	34,304,870	806,131	100,397,901
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (394)	\$ (942)	\$ (164)	\$ (1,500)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS				
Licenses and Permits	\$ (67)	\$ (239)		\$ (306)
Taxes	(109)	(104)		(213)
Charges for Services		(223)		(223)
Fines and Forfeits	(117)			(117)
Grants, Contracts, and Donations		(118)		(118)
Transfers-in		(67)		(67)
Federal Indirect Cost Recoveries		(73)	\$ (1)	(74)
Miscellaneous	(101)	(118)		(219)
Federal			(163)	(163)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (394)	\$ (942)	\$ (164)	\$ (1,500)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-9.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2012

	Central Management	Insurance	Local Assistance to Counties	Securities	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT					
Personal Services					
Salaries	\$ 771,775	\$ 2,825,286		\$ 503,470	\$ 4,100,531
Employee Benefits	250,527	926,142		172,181	1,348,850
Total	<u>1,022,302</u>	<u>3,751,428</u>		<u>675,651</u>	<u>5,449,381</u>
Operating Expenses					
Other Services	33,426	1,922,793		127,929	2,084,148
Supplies & Materials	27,699	129,471		24,265	181,435
Communications	22,963	181,697		34,661	239,321
Travel	18,868	104,699		23,986	147,553
Rent	90,950	324,604		68,869	484,423
Repair & Maintenance	326	887		212	1,425
Other Expenses	38,688	132,329		35,312	206,329
Total	<u>232,920</u>	<u>2,796,480</u>		<u>315,234</u>	<u>3,344,634</u>
Equipment & Intangible Assets					
Equipment	3,887	11,276		1,041	16,204
Total	<u>3,887</u>	<u>11,276</u>		<u>1,041</u>	<u>16,204</u>
Local Assistance					
From other sources			\$ 26,328,016		26,328,016
Total			<u>26,328,016</u>		<u>26,328,016</u>
Benefits & Claims					
To Individuals		925,563			925,563
From State Sources		9,341,233		13,750	9,354,983
Total		<u>10,266,796</u>		<u>13,750</u>	<u>10,280,546</u>
Transfers-out					
Fund transfers		50,625		4,964,919	5,015,544
Total		<u>50,625</u>		<u>4,964,919</u>	<u>5,015,544</u>
Total Expenditures & Transfers-Out	\$ <u>1,259,109</u>	\$ <u>16,876,605</u>	\$ <u>26,328,016</u>	\$ <u>5,970,595</u>	\$ <u>50,434,325</u>
EXPENDITURES & TRANSFERS-OUT BY FUND					
General Fund			\$ 26,328,016		\$ 26,328,016
State Special Revenue Fund	\$ 1,259,109	\$ 16,013,688		\$ 5,970,595	23,243,392
Federal Special Revenue Fund		862,917			862,917
Total Expenditures & Transfers-Out	<u>1,259,109</u>	<u>16,876,605</u>	<u>26,328,016</u>	<u>5,970,595</u>	<u>50,434,325</u>
Less: Nonbudgeted Expenditures & Transfers-Out	(248)	90,649		5,070,188	5,160,589
Prior Year Expenditures & Transfers-Out Adjustments	803	(170,190)	1,339	(1,238)	(169,286)
Actual Budgeted Expenditures & Transfers-Out	<u>1,258,554</u>	<u>16,956,146</u>	<u>26,326,677</u>	<u>901,645</u>	<u>45,443,022</u>
Budget Authority	1,308,436	18,101,836	27,723,706	1,397,995	48,531,973
Unspent Budget Authority	\$ <u>49,882</u>	\$ <u>1,145,690</u>	\$ <u>1,397,029</u>	\$ <u>496,350</u>	\$ <u>3,088,951</u>
UNSPENT BUDGET AUTHORITY BY FUND					
General Fund			\$ 1,397,029		\$ 1,397,029
State Special Revenue Fund	\$ 49,882	\$ 664,695		\$ 496,350	1,210,927
Federal Special Revenue Fund		480,995			480,995
Unspent Budget Authority	\$ <u>49,882</u>	\$ <u>1,145,690</u>	\$ <u>1,397,029</u>	\$ <u>496,350</u>	\$ <u>3,088,951</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

STATE AUDITOR'S OFFICE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2011

A-8

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Central Management	Insurance	Local Assistance to Counties	Securities	Total
Personal Services					
Salaries	\$ 753,083	\$ 2,691,696		\$ 486,811	\$ 3,931,590
Employee Benefits	249,310	892,351		167,112	1,308,773
Total	<u>1,002,393</u>	<u>3,584,047</u>		<u>653,923</u>	<u>5,240,363</u>
Operating Expenses					
Other Services	32,170	1,439,495		67,069	1,538,734
Supplies & Materials	48,279	172,704		45,920	266,903
Communications	31,036	130,632		20,600	182,268
Travel	11,784	105,902		28,288	145,974
Rent	87,345	281,675		57,818	426,838
Repair & Maintenance	138	366		29	533
Other Expenses	27,939	149,090		16,644	193,673
Total	<u>238,691</u>	<u>2,279,864</u>		<u>236,368</u>	<u>2,754,923</u>
Equipment & Intangible Assets					
Equipment	3,336	81,065		45,559	129,960
Total	<u>3,336</u>	<u>81,065</u>		<u>45,559</u>	<u>129,960</u>
Local Assistance					
From other sources			\$ 25,019,293		25,019,293
Total			<u>25,019,293</u>		<u>25,019,293</u>
Benefits & Claims					
To Individuals		828,315			828,315
From State Sources		11,593,314			11,593,314
Total		<u>12,421,629</u>			<u>12,421,629</u>
Transfers-out					
Fund transfers		20,827		3,278,492	3,299,319
Total		<u>20,827</u>		<u>3,278,492</u>	<u>3,299,319</u>
Total Expenditures & Transfers-Out	\$ <u>1,244,420</u>	\$ <u>18,387,432</u>	\$ <u>25,019,293</u>	\$ <u>4,214,342</u>	\$ <u>48,865,487</u>
EXPENDITURES & TRANSFERS-OUT BY FUND					
General Fund			\$ 25,019,293		\$ 25,019,293
State Special Revenue Fund	\$ 1,244,420	\$ 17,581,465		\$ 4,214,342	23,040,227
Federal Special Revenue Fund		805,967			805,967
Total Expenditures & Transfers-Out	<u>1,244,420</u>	<u>18,387,432</u>	<u>25,019,293</u>	<u>4,214,342</u>	<u>48,865,487</u>
Less: Nonbudgeted Expenditures & Transfers-Out	(164)	7,428		3,295,476	3,302,740
Prior Year Expenditures & Transfers-Out Adjustments	(133)	(48,794)	(100,659)	4	(149,582)
Actual Budgeted Expenditures & Transfers-Out	<u>1,244,717</u>	<u>18,428,798</u>	<u>25,119,952</u>	<u>918,862</u>	<u>45,712,329</u>
Budget Authority	<u>1,378,841</u>	<u>24,757,771</u>	<u>26,344,568</u>	<u>1,218,008</u>	<u>53,699,188</u>
Unspent Budget Authority	\$ <u>134,124</u>	\$ <u>6,328,973</u>	\$ <u>1,224,616</u>	\$ <u>299,146</u>	\$ <u>7,986,859</u>
UNSPENT BUDGET AUTHORITY BY FUND					
General Fund			\$ 1,224,616		\$ 1,224,616
State Special Revenue Fund	\$ 134,124	\$ 4,985,062		\$ 299,146	5,418,332
Federal Special Revenue Fund		1,343,911			1,343,911
Unspent Budget Authority	<u>134,124</u>	<u>6,328,973</u>	<u>1,224,616</u>	<u>299,146</u>	<u>7,986,859</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

State Auditor's Office

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2012

1. Summary of Significant Accounting Policies

Basis of Accounting

The office uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, and Federal Special Revenue funds). In applying the modified accrual basis, the office records:

- ♦ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ♦ Expenditures for valid obligations when the office incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the office to record the cost of employees' annual and sick leave when used or paid.

The office uses accrual basis accounting for its Fiduciary (Private-Purpose Trust and Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the office records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the office receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The office uses the following funds:

Governmental Fund Category

- ♦ **General Fund** – to account for all financial resources except those required to be accounted for in another fund. The General Fund includes revenue for insurance premium tax, securities brokerage licenses, fines and penalties, and transfers in from securities and captive insurance state special revenue funds. The expenditures included in the general fund are transfers of funds to Montana Public Employee's Retirement Administration and expenditures to each city or town that has a fire department relief association or a

police department that is not a participant in the municipal police officer's retirement system.

- ♦ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Office State Special Revenue Funds include Insurance and Security Division activity, such as securities portfolio registrations revenue, insurance license revenue, examination fees, industry continuing education programs, and Insure Montana activity.
- ♦ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Office Federal Special Revenue Funds includes three Affordable Care Act grants. The grants are Health Insurance Premium Review Grant, State Planning and Establishment Grant for the Affordable Care Act Exchanges, and the Consumer Assistance Program Grant.

Fiduciary Fund Category

- ♦ **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income benefit individuals, private organizations, or other governments. The office's private-purpose trust fund includes the fiscal year 2011-12 financial deposits required to be held in trust by the office for insurance companies licensed in Montana. The office reclassified the fund in fiscal year 2011-12 from an agency fund to a private-purpose trust fund.
- ♦ **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. The office's agency fund includes the fiscal year 2010-11 financial deposits required to be held in trust by the office for insurance companies licensed in Montana. The fund was closed in fiscal year 2011-12, and the private-purpose trust fund was created to account for the deposits.

2. General Fund Balance

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The office has authority to pay obligations from the statewide General Fund within its appropriation limits. The office expends cash or other assets from the statewide fund when it pays General Fund obligations. The office's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund balances for each of the fiscal years ended June 30, 2012, and June 30, 2011.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General and State Special Revenue funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies. The significant portion of direct entries in both the General Fund and State Special Revenue Fund relate to resources from premium insurance tax revenues.

4. Statutorily Required Deposits

Section 33-2-111, MCA, requires insurance companies licensed to transact business in Montana to deposit cash or securities for the protection of policyholders in an account held in trust by the commissioner. The office reported trust accounts in the agency fund in fiscal year 2010-11. In fiscal year 2011-12, the office decided to report trust accounts using a private-purpose trust fund rather than an agency fund. The agency fund was closed in fiscal year 2011-12. The private-purpose trust fund is not reflected on the Schedule of Changes in Fund Balances for fiscal year 2011-12.

5. Agency Fund – Additions & Reductions to Property Held in Trust

The Additions and Reductions to Property Held in Trust on the Schedule of Changes in Fund Balance & Property Held in Trust reflect the cumulative totals of transactions and adjustments posted to the Agency Fund. In fiscal year 2010-11, the total additions of \$15,744,274 and total reductions of \$13,727,552 included a significant adjusting entry to the accounting records. Adjustments were made to both additions and reductions of \$12,704,324 to update sub-account titles. Actual transactions in the Additions and Reductions to Property Held in Trust were \$3,039,950 and \$1,023,228, respectively.

STATE AUDITOR'S
OFFICE

OFFICE RESPONSE

COMMISSIONER OF SECURITIES & INSURANCE

MONICA J. LINDEEN
COMMISSIONER



OFFICE OF THE MONTANA
STATE AUDITOR

RECEIVED

DEC 06 2012

LEGISLATIVE AUDIT DIV.

December 6, 2012

Ms. Tori Hunthausen
Legislative Auditor
Office of the Legislative Auditor
State Capitol
P.O. Box 201705
Helena, Mt. 59620-1705

Dear Ms. Hunthausen:

The State Auditor's Office received the financial compliance audit for the two fiscal years ending June 30, 2012. Thank you for the opportunity to respond to the recommendations.

Recommendation #1

We recommend the office enhance existing policies to incorporate segregation of duties during high revenue collection periods.

Agency Response:

Concur. The office will enforce the existing Internal Control Policy at all times.

Recommendation #2

We recommend the office account for its private-purpose trust fund activity in accordance with state law and accounting policy.

Agency Response:

Concur. Accounting entries will be made by FYE to correct the recording of the private purpose trust fund. The cash balance is fully accounted for; the recording accounts need to be adjusted.

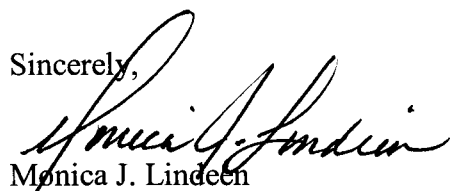
Recommendation #3

We recommend the office follow state accounting policy when recording current activity versus corrections of errors through direct entries to fund balance.

Agency Response:

Concur. In regards to the first example, the issue is resolved. The second issue involves approval of processing the correcting journals from two other departments. The agency is in the process of coordinating with the other departments to process the prior year adjustment against fund balance, rather than transfers-in. This issue will be resolved by FYE.

Sincerely,

A handwritten signature in black ink, appearing to read "Monica J. Lindeen". The signature is fluid and cursive, with a large initial 'M' and 'L'.

Monica J. Lindeen
Commissioner of Securities & Insurance
Office of the Montana State Auditor